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No. 73-402

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# In the Supreme Court of the United States

OCTOBER TERM, 1973

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ROSE ANN COATES TRUST, ET AL., PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

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## MEMORANDUM FOR THE RESPONDENT

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ROBERT H. BORK,
*Solicitor General,*
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*Washington, D.C. 20530.*

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### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1—A-8) is reported at 480 F. 2d 468. The findings of fact and opinion of the Tax Court (Pet. App. A-9—A-27) are reported at 55 T.C. 501.

### JURISDICTION

The judgment of the court of appeals was entered on June 5, 1973 (Pet. App. A-1). The petition for a writ of certiorari was filed on September 1, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

### QUESTION PRESENTED

Whether the purchase of stock of one corporation by another corporation, both of which are under common control, is a redemption by a related corporation under

Section 304 of the Internal Revenue Code of 1954, resulting in treating the proceeds as dividends to the shareholders of the purchasing corporation.

## STATUTES INVOLVED

The pertinent provisions of Sections 301, 302, 304 and 351 of the Internal Revenue Code of 1954 are set forth at Pet. App. A-28—A-31.

## STATEMENT

Sydney Coates and Rose Ann Coates, together with their children, children's spouses, and grandchildren, owned all of the stock of two corporations, CAM Industries, Inc. ("CAM") and Washington Industrial Products ("WIP") (Pet. App. A-1). After the death of Sydney Coates, the family group agreed to combine the two corporations by having CAM "purchase" all the shares of WIP stock (Pet. App. A-1). To effect this "purchase," CAM and all the WIP shareholders entered into agreements entitled "Agreement for Sale of Stock" whereby CAM agreed to purchase all WIP stock at $1,000 per share. The purchase price was payable over a period not to exceed 10 years (Pet. App. A-2, A-3, A-15—A-16).

Immediately prior to CAM's acquisition of WIP stock, the Estate of Sydney Coates owned 75 shares of the 300 shares of WIP stock outstanding (Pet. App. A-2). Petitioner trusts were distributees of the Estate of Sydney Coates (Pet. App. A-3). The individual petitioners herein are four of Sydney Coates' grandchildren each of whom, prior to the acquisition, owned six shares of WIP stock[1] (Pet. App. A-2).

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[1] The other Coates family members who owned WIP stock (Pet. App. A-2) were not involved in this case either because their redemptions were found to be substantially disproportionate pursu-

Section 304 of the Internal Revenue Code of 1954 treats the purchase by one corporation of stock in another corporation, both of which are under common control, as a redemption of the stock of the purchasing corporation to be taxed under Section 302 of the Code, rather than a sale to an independent third party. Section 351 of the Code provides, however, that no gain or loss shall be recognized if property is transferred to a corporation in exchange for "stock or securities" in such corporation, and the transferor or transferors are immediately thereafter in control of the transferee corporation.

In the Tax Court, petitioners asserted that the transaction was a tax-free acquisition controlled by Section 351. The Commissioner held, however, that the transaction was a redemption by a related corporation under Section 304 of the Code, and thereby taxable, at the fact value of the agreements ($1,000 per share), as a divident under Section 302(d) of the Code. The Tax Court upheld the Commissioner's determinations but reduced the amount of the dividend to 60 percent of the face value of the agreements.

In the courts below, as here, petitioners contended that Section 351 rather than Section 304 controlled, on the alternative grounds that Section 351 in terms applied and that, if both Sections 304 and 351 applied, the latter was controlling. The Tax Court, however, did not reach the question whether Section 304 or Section 351 governed the transaction, since it held Section 351 inapplicable because the sales agreements were not "stock or securities" within the meaning of that provision. Since the transaction was not within Section 351, the Tax Court concluded that Section 304 controlled.

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ant to Section 302(b)(2) of the Code, or because other matters pertaining to their 1965 income tax returns had not been resolved at the time this action was instituted (Pet. App. A-4).

The court of appeals affirmed (Pet. App. A-8). It assumed without deciding that the sales agreements constituted securities under Section 351, and held that Section 304 rather than Section 351 controls where the terms of both provisions apply to a transaction (Pet. App. A-6).

## DISCUSSION

The court of appeals held in this case that Section 304 and not Section 351 controls in the present type of transaction where both sections by their terms apply. As the court recognized (Pet. App. A-6), its decision conflicts with that of the Court of Appeals for the Sixth Circuit in *Commissioner* v. *Stickney*, 399 F. 2d 828, affirming 46 T.C. 864. In *Stickney*, the Sixth Circuit held that where both sections by their terms apply, the nonrecognition provisions of Section 351 control.[2] In view of this direct conflict, the government does not oppose the granting of the petition for a writ of certiorari.

The importance of the question, however, is uncertain at this time. The present case and *Stickney* are the only two judicial decisions on the problem. The Internal Revenue Service has advised us that it has pending in its Appellate Division at most one case involving the problem. It is not certain how many cases presenting the issue are pending at the primary audit level.

Moreover, the present case presents the issue in a somewhat unusual context, since the court of appeals

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[2] The *Stickney* decision has been sharply criticized. See, *e.g.*, Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders* (3d ed.), par. 9.32; Marans, *Section 304: The Shadowy World of Redemptions through Related Corporations*, 22 Tax L. Rev. 161. The Commissioner has announced his nonacquiescence in the decision. See Rev. Rul. 73-2, I.R.B. No. 1973-1 (January 2, 1973).

assumed *arguendo,* contrary to the ruling of the Tax Court, that the sales agreements were "securities" within the meaning of Section 351 and then held that Section 304 rather than Section 351 governs. The usual practice would have been for the court of appeals first to have reviewed the holding of the Tax Court that the sales agreements were not securities, instead of assuming *arguendo* the incorrectness of that holding and deciding the statutory question.[3]

For these reasons, the Court might conclude that this is not an appropriate case in which to resolve the conflict. On the other hand, the ground upon which the court of appeals decided this case indicates that different sections of the Code now govern the same transaction in the Sixth and Ninth Circuits.

Respectfully submitted.

ROBERT H. BORK,
*Solicitor General.*

OCTOBER 1973.

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[3] Whether the agreements were stock or securities is a question of fact upon which petitioners had the burden of proof. *Camp Wolters Enterprises, Inc.* v. *Commissioner,* 22 T.C. 737, affirmed, 230 F. 2d 555 (C.A. 5). See also *Shannon* v. *Commissioner,* 29 T.C. 702.